

# Developing people of talent and commitment

WANTED: AN ONGOING SUPPLY OF PEOPLE WITH TALENT AND COMMITMENT TO JOIN  
A HIGH-CALIBRE TEAM WORKING IN AUSTRALASIA'S MOST EXCITING GROWTH SECTOR.

Telecom has always attracted good people. Our engineers have long been rated as second to none, and we have continually sought to recruit and develop people who will contribute to our success in a fast-changing world. As our business transforms and grows, so Telecom must transform the mix of talent and experience among its people.

Over the past decade, telecommunications in New Zealand has grown into a complex industry of diverse network operators and service providers, supported by many suppliers. The industry has become an increasingly attractive career choice for people with diverse backgrounds and expertise.

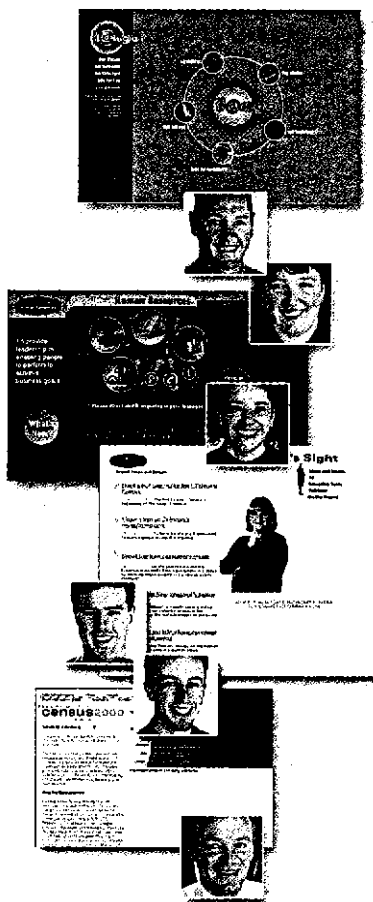
From an historical focus on engineering capability for delivering voice telephony, Telecom has moved to having a range of talent that includes web developers, sales specialists, and IP and data capability strategists. The challenges we face in online and communications markets are reflected in the challenges we face in recruiting and retaining the right people.

Telecom recognises fundamental changes in the nature of work. People increasingly seek self-development in their work and look beyond the more traditional goals of security and status. Many see their working lives as a series of chapters, rather than a single career marked by lineal progression within one organisation or industry. Even the definition of employment is changing and a growing number of people prefer to work in contractual relationships with different companies and agencies.

Telecom has 5,717 full-time employees, including 109 off-shore, and around 2,300 contractors (including outsourced arrangements). Over 3,000 of these are frontline people, working with customers directly. We have outsourced arrangements with EDS for Telecom's information services needs and with SITEL for some of our call centre operations. These arrangements are all part of our drive to have contestable delivery of services and to work with strategic allies for quality service both externally and internally.

Theresa Gattung's Executive Team is committed to a collaborative leadership style, with the optimum balance between individual accountability and teamwork. Thinking and acting as teams is critical in every area of the business. Consistent with this, management structures have become flatter, and programmes have been designed to encourage people to collaborate across business boundaries, form virtual project teams and take collective responsibility for setting and achieving objectives.

Inevitably, Telecom has a level of employee turnover, and recruitment of new people of talent and commitment is vital. For this, we have gone online with an eRecruitment solution to harness the Internet for attracting the people we need into the future.



## ONLINE FOR PEOPLE

- eRECRUITMENT TO MARKET JOBS
- INTRANET TO COMMUNICATE  
TRAINING OPPORTUNITIES

THE DIRECTORS OF TELECOM CORPORATION OF  
NEW ZEALAND LIMITED ON 30 JUNE 2000 WERE:



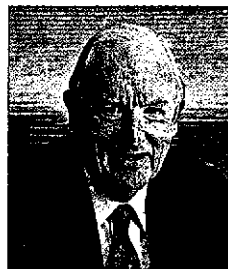
**RODERICK DEANE,**  
CHAIRMAN

Roderick Deane became Chairman in October 1999 after seven years as Chief Executive and Managing Director. He was named Chief Executive of the Decade in 1999 in the Top 200 New Zealand corporate awards. Dr Deane also chairs Fletcher Challenge Limited, Te Papa Tongarewa (The Museum of New Zealand) and the ANZ Banking Group (New Zealand) Limited. He is a Director of the Australia and New Zealand Banking Group Limited (Melbourne), TransAlta Corporation (Canada), Woolworths Limited (Australia) and eVentures New Zealand Limited. He is on the boards of the Centre for Independent Studies in Sydney and the Institute of Policy Studies at Victoria University of Wellington, and is Professor of Economics and Management at Victoria University of Wellington (a part-time position). Jointly, along with his wife Gillian, Dr Deane is Patron of IHC New Zealand Inc and is a member of the IHC Board of Governance. He is Chairman of the City Gallery Wellington Foundation and has an active interest in promoting the arts and music.



**THERESA GATTUNG,**  
CHIEF EXECUTIVE AND MANAGING  
DIRECTOR

Theresa Gattung became Chief Executive in October 1999. She had previously been Group General Manager, Services and before that General Manager, Marketing. Before joining Telecom in 1994, Ms Gattung was Chief Manager, Marketing for Bank of New Zealand, and had previously held executive positions with National Mutual and TVNZ. She graduated with a Bachelor of Laws (LLB) from Victoria University in 1987 and a Bachelor of Management Studies (Honours, with majors in Economics and Marketing) from the University of Waikato in 1983. Her entire career has been in "new economy" companies - telecommunications, media, information technology, banking and finance.



**PETER SHIRTCLIFFE**

Peter Shirtcliffe has been a Director since April 1987 when Telecom was created as a State Owned Enterprise. He was appointed Chairman in September 1990 and retired from this role in September 1999. Mr Shirtcliffe was Managing Director of foodstuffs producer and distributor Goodman Group Limited from 1976-1985 and Chairman of the New Zealand Trade Development Board from 1985-1990. He is currently a member of the Executive Committee of the Australia and New Zealand Business Council, and a trustee of, or consultant to, a number of charitable trusts.



**JOHN KING**

John King, LLB, has been a Telecom Director since September 1990. He is Senior Partner with law firm Russell McVeagh, a Director of WestpacTrust Investments Ltd, Chairman of the Takeovers Panel, a member of the Board of the Employers and Manufacturers Association (Northern) Inc and of the Spirit of Adventure Trust Board.



PATSY REDDY

Patsy Reddy joined the Board in December 1997. She is an Executive Director of Active Equities Limited and a Non-Executive Director of Sky City Limited, Infinity Group Limited and New Zealand Opera Limited. She is also Trustee of the Sky City Community Trust. From 1987 to 1998 Ms Reddy was a Senior Executive at Brierley Investments Limited, before which she was a partner in law firm Rudd Watts & Stone. She has also been a lecturer in the Law Faculty at Victoria University of Wellington.



MICHAEL TYLER

Michael Tyler is Managing Director and Senior Partner of London-based professional services firm Tyler & Company, which provides advisory and analytical services in the telecommunications, media and electronic commerce fields. He joined the Board in June 1999. Before founding Tyler & Company, Mr Tyler was a Senior Partner and Director at Putnam, Hayes & Bartlett Inc, where he headed the telecommunications consulting business, and before that he led the telecommunications practice as a Partner and Vice-President at Booz, Allen & Hamilton Inc. Mr Tyler started his telecommunications career at British Telecom in 1972 and has worked in the advisory, research, educational and venture investment fields since 1976. Mr Tyler is also a Director of Swedish software, systems integrator and operations support company ConNova AB.



PAUL BAINES

Paul Baines joined the Board in May 1998. He is Chairman of Tower Managed Funds and a Director of Comalco New Zealand, Fletcher Challenge, Gough, Gough and Hamer, Greenstone Fund, New Zealand Post, Reserve Bank of New Zealand, South Eastern Utilities and Wrightson. Mr Baines has been Chief Executive Officer of CS First Boston New Zealand and before that held a number of senior positions at sharebroking and investment banking firm Jarden & Co. He has degrees in accountancy, economics and public policy.

THE EXECUTIVE GROUP CONSISTS OF SENIOR MANAGERS WHO EACH RUN MAJOR UNITS WITHIN TELECOM AND REPORT DIRECTLY TO THE CHIEF EXECUTIVE.



THERESA GATTUNG

KEVIN STRATFUL

DAVID BEDFORD

MOHAN JESUDASON

MARK RATCLIFFE

GRAHAM MITCHELL

**THERESA GATTUNG**, CHIEF EXECUTIVE leads the company's Executive Team, overseeing the day-to-day management of Telecom on behalf of the Board of Directors. The team meets regularly to consider strategy, policy, investment and corporate activities, and to monitor business performance. It also advises the Chief Executive on matters such as strategy and policy.

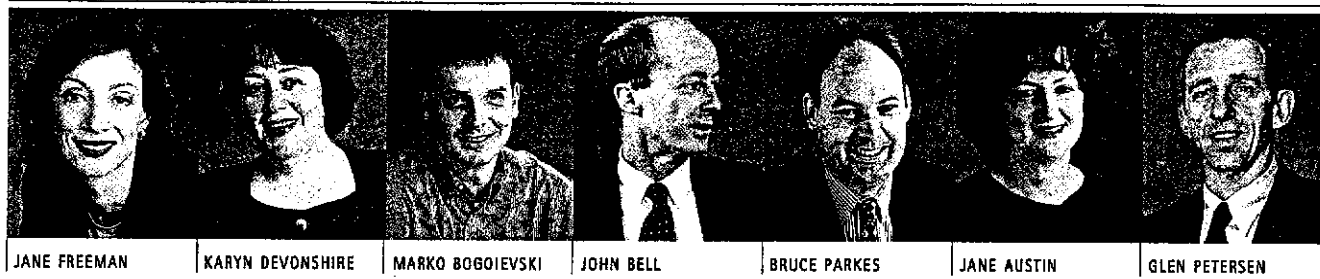
**KEVIN STRATFUL'S SALES AND SERVICE GROUP** is responsible for meeting the telecommunications needs of our consumer, business and corporate customers. It markets Telecom's services to customers, bills them for services and manages the relationships. Kevin joined Telecom as Group General Manager Sales and Service in January 2000. Prior to joining Telecom, Kevin was Managing Director of Freightways and prior to this, Managing Director of Lion Nathan New Zealand. He has over 25 years' experience in sales and marketing across a range of industries.

**DAVID BEDFORD'S NETWORK GROUP** plans, develops, operates and manages the maintenance of Telecom's fixed-line, international and broadband networks. David is also responsible for Telecom's corporate information technology and systems function, which includes management of its outsourcing partnership with EDS. He was appointed Group General Manager Network in July 1998 from his role as Group General Manager Enterprises. He was previously General Manager, Human Resources and has worked at Electricity Corporation of New Zealand, Bechtel Corporation, Weddell Group and Downer & Company Limited.

**MOHAN JESUDASON'S MOBILE BUSINESS UNIT** is responsible for all aspects of our mobile business. Mohan joined Telecom in September 1996 as General Manager Business. He was appointed to his new role as General Manager Mobile in December 1999. Prior to coming to Telecom, Mohan spent 16 years with AXA in Melbourne and New Zealand where he held a variety of senior positions in marketing, distribution and general management.

**MARK RATCLIFFE'S DATA & VOICE GROUP** is accountable for developing and marketing Telecom's range of data and voice products and services. Mark was appointed in December 1999 from his role as General Manager Product & Service Development. He has worked in a variety of senior roles over his ten-year career at Telecom. Prior to coming to Telecom, Mark worked in senior accounting, IT, project management and consulting roles in England and New Zealand.

**GRAHAM MITCHELL** is GENERAL MANAGER OF TELECOM INTERNET & MEDIA properties, which encompass the Xtra and Telecom Directories Limited businesses and associated brands. Graham is also a Board Member of AOL Australia which is a Joint Venture between AOL International and AAPT. Graham was appointed to his role in April 1999. He came to Telecom from Brierley Investments Limited where he was New Zealand Investments Manager. Graham has previously held senior management positions with Telecom and Electricity Corporation of New Zealand.



JANE FREEMAN

KARYN DEVONSHIRE

MARKO BOGOIEVSKI

JOHN BELL

BRUCE PARKES

JANE AUSTIN

GLEN PETERSEN

**JANE FREEMAN** is GENERAL MANAGER OF ESOLUTIONS. esolutions is the alliance with EDS and Microsoft in New Zealand and delivers a full range of e-commerce applications to corporate and business customers. esolutions will play a key part in the realisation of our vision to lead New Zealanders online. Jane started at Telecom in December 1999. She has a strong e-commerce background, having launched BankDirect, the first totally phone and Internet bank in New Zealand. Previously she was Chief Manager Marketing at the ASB and General Manager Residential Markets for Clear Communications. Jane is accountable to an Advisory Board of representatives of all three parent companies of esolutions.

**KARYN DEVONSHIRE'S** TCNZ CORPORATE, AUSTRALIA GROUP is at the cutting edge of developing Telecom's presence in the Australian corporate market, including the contract with the Commonwealth Bank of Australia. Karyn took up her role as Group General Manager in May 2000. She joined Telecom in December 1997 and was appointed General Manager Corporate Strategy and Information Services in March 1999. Her role expanded to include development of online systems. Previously, Karyn held a variety of information system roles at the New Zealand Dairy Board. She has experience in the insurance, services, manufacturing and international consumer marketing sectors.

**MARKO BOGOIEVSKI** CHIEF FINANCIAL OFFICER. The Finance Group provides business and financial information, analysis and advice to help Telecom maximise shareholder value. The Finance Group also oversees strategy, investor relations, treasury operations, corporate finance and shared corporate services. Marko has held a number of senior financial, operational and sales roles with Ansett New Zealand, Lion Nathan, Elders Finance Group and Price Waterhouse and more recently helped launch a US start-up company.

**JOHN BELL'S** BUSINESS DEVELOPMENT GROUP evaluates new business opportunities within the converging telecommunications, information technology and entertainment sectors to see if they have the potential to create long-term shareholder value. John joined Telecom in May 1996 from Fujitsu New Zealand Limited, where he was Managing Director. He has also worked for IBM New Zealand Limited and Beca Carter Hollings and Ferner (BCHF).

**BRUCE PARKES'** GOVERNMENT AND INDUSTRY RELATIONS team manages Telecom's relationship with the Government. Bruce came to Telecom in 1993 from Electricity Corporation of New Zealand. He was appointed to his current position in November 1999 having previously been Manager of our Industry Services Unit. Bruce has a strong strategy, marketing and economics background. His other roles in Telecom include managing the Services Strategy Group.

**JANE AUSTIN'S** CORPORATE COMMUNICATIONS GROUP develops frameworks to sustain and increase the value of Telecom's brand. The group also directly supports the brand through communications with shareholders, staff, media and communities. Jane joined Telecom 11 years ago from British Telecom. Her roles in Telecom have spanned communications, service and sales, and, prior to taking up her current role in December 1999, she managed branding strategy in the Services team. This followed a period heading up Business Service and Indirect Channels.

**GLEN PETERSEN'S** HUMAN RESOURCES GROUP develops strategies, policies and business unit HR programmes for managing participation by Telecom employees in creating value. Glen was appointed General Manager, Human Resources in August 2000. He was previously General Manager, Human Resources, Commercial and Consumer at Telstra Corporation. He has extensive senior level experience in human resources over the past 20 years including various roles with Pizza Hut in Australia and North America and then Lion Nathan trans-Tasman. In 1995 Glen joined Arnotts and was Vice President Human Resources for several years prior to joining Telstra in 1999.

THE GENERAL COUNSEL AND COMPANY SECRETARY oversees the provision of legal, secretariat and risk management services to Telecom to ensure that the company uses sound business practices. (Position vacant as this report went to print.)

THE BOARD OF DIRECTORS IS ELECTED BY THE SHAREHOLDERS TO GOVERN THE COMPANY IN SHAREHOLDERS' INTERESTS AND IS THE OVERALL AND FINAL BODY RESPONSIBLE FOR ALL DECISION-MAKING.

The Board has delegated some of its powers to Board committees and other powers to the Chief Executive. The Chief Executive has formally delegated certain authorities to her executives and has established a formal process for those executives to further delegate certain authorities to their managers.

**ROLE OF THE BOARD** The Board establishes the Telecom Group's objectives and medium-term strategic financial plan, major strategies for achieving these objectives, annual budgets and the overall policy framework within which business is conducted. The Board takes advice from independent sources and from the Chief Executive relating to changes to the business, performance goals, strategies and policy frameworks of the Telecom Group. The Board monitors Management's performance relative to these goals and plans, and reports to shareholders at least once a year at the Annual Meeting.

**BOARD OPERATIONS** The Board comprises seven Directors, being a non-executive Chairperson, an executive Director, and five non-executive Directors. Directors in office at 30 June 2000, are set out elsewhere in this report. Procedures for the operation of the Board, including the appointment and removal of Directors, are governed by the Company's Constitution.

The full Board formally met fifteen times during the financial year ended 30 June 2000. Two of these meetings spanned two days.

**Attendance at Board and Committee Meetings** for period 1 July 1999 to 30 June 2000:

	Shirtcliffe	Deane	Gattung	King	Reddy	Baines	Tyler
TCNZ Board	13	15	8*	15	15	15	13
HR/ Committee	2***	5***	5**	6	7		
Audit Committee	1***	1***	1**			2	1

\* Ms Gattung was appointed to the Board in October 1999.

\*\* Ms Gattung is not a member of the Audit and HR Compensation Committees but is entitled to attend meetings.

\*\*\* The Chairman is an ex-officio member of the HR/Compensation and Audit Committees. Mr Shirtcliffe was Chairman until 30 September 1999 and Dr Deane became Chairman on 1 October 2000.

**BOARD COMMITTEES** The Board has two formally constituted Committees, the Human Resources/Compensation Committee and the Audit Committee. The Human Resources/Compensation Committee comprises three non-executive Directors and the Audit Committee comprises three non-executive Directors, which in both cases include the Chairman, who is an ex-officio member of both Committees.

The Human Resources/Compensation Committee, chaired by Patsy Reddy, is responsible for overseeing the policy framework for human resources activities within the Telecom Group, including overseeing senior management succession planning, establishing employee incentive schemes, reviewing and approving the compensation arrangements for the Chief Executive and managers who report directly to the Chief Executive, and recommending to the full Board the compensation of Directors. The Audit Committee, chaired by Mr Baines, is responsible for overseeing the financial policies of the Telecom Group, including financial delegations, internal controls, internal and external audit, liaising with the Telecom Group's independent auditors and making recommendations to the Board as to their appointment and remuneration.

**GOVERNANCE PRINCIPLES** The Board has established Telecom's governance policy to outline what it expects from the people to whom it has delegated financial and decision-making authority. Telecom's governance principles, which are a very broad description of the way in which the Board expects the Company to be managed for shareholders' benefit, are:

1. Future shareholder value will be built from additional growth.
2. Telecom will be market-focused.
3. The organisational structure will support Telecom's strategies.
4. The structure will support individual accountability.
5. Telecom's policy and strategy framework will be decided at corporation level. Business and operational decisions will be made by management and staff within corporate frameworks.
6. Business plans will determine accountability for resources and budgets.
7. Contestability will drive efficiency.

**MANAGEMENT OVERSIGHT** Telecom Directors and the Chief Executive oversee managers to ensure they make decisions in line with corporate policy and direction. An Executive Team, comprising managers who report directly to the Chief Executive, meets regularly to consider and advise the Chief Executive on matters including strategy, policy, investment, and corporate activities, and to monitor performance by the various business groups against strategies and plans. Membership of the Executive Team is set out elsewhere in this report.

**DELEGATION FRAMEWORK** The Telecom Group has formal policy frameworks in place relating to its principal operations, delegations of financial authority to managers, and compliance with statutory requirements. The Board's delegation of the conduct of the day-to-day affairs of the Company to the Chief Executive is made within this framework. The practices and processes used by the Board, Chief Executive, Executive Team, and senior managers to implement governance include:

1. Delegated management authority.
2. Individual accountability.
3. Delegated financial authority.

Delegated management authority means that limits are set on decision-making and certain decisions require approvals from senior managers, and executives or the Board. However, approval does not involve re-making decisions. Individual accountability means individuals are responsible for achieving specific agreed outcomes; measuring outcomes wherever possible; planning, budgeting and acquiring the resources they need to achieve their accountabilities; and monitoring the use of resources used in achieving their outcomes. Delegated financial authority means that Telecom managers have authority to approve spending up to specified financial limits, with approval from senior managers, Executive Team or the Board needed for expenditure or budget allocation beyond the limits. These limits are reviewed periodically and are set at levels that ensure a proportion of management decisions are discussed by both the decision-maker and their manager, the Executive Team or Board.

# Management's Discussion and Analysis of Financial Condition and Results of Operations 30 June 2000

## RESULTS OF OPERATIONS

### OVERVIEW OF RESULTS

In November 1999, Telecom increased its shareholding in AAPT from 19.7% to approximately 80% (79.9% as at 30 June 2000). Telecom's result for the year ended 30 June 2000 ("2000") reflects the consolidation of AAPT's earnings from 1 December 1999, the amortisation of associated goodwill from 1 December 1999 and the costs of funding the investment in AAPT for the year.

Reported net earnings of NZ\$783 million for 2000 decreased by NZ\$51 million, or 6.1%, from NZ\$834 million for the year ended 30 June 1999 ("1999").

Net earnings for the year represented earnings per share ("EPS") of NZ44.7 cents. EPS decreased by 6.2% for the year compared with 1999.

Excluding the effect of the investment in AAPT, Telecom's net earnings would have been NZ\$846 million for the year, an increase of NZ\$20 million, or 2.4%, compared with last year's normalised earnings of NZ\$826 million (see "Reconciliation of Earnings before and after AAPT").

### Dividends

Telecom will pay a fully imputed fourth quarter dividend of NZ11.5 cents per ordinary share in September 2000, bringing the dividend for the year ended 30 June 2000 to NZ46.0 cents. The full-year dividend of NZ46.0 cents represents a distribution of approximately 98% of net earnings before amortisation costs. The dividend for the year ended 30 June 1999 was also NZ46.0 cents per ordinary share.

Telecom is committed to further growth in the Australian market, building on its shareholding in AAPT and supporting AAPT's network investment programme. Telecom is also pursuing growth in its New Zealand-based business, including the roll-out of its CDMA mobile network and new broadband technologies, and expansion of international capacity through the Southern Cross Cable.

These investments for future growth, including those which might arise in the future but which have yet to be identified, require Telecom to maintain strong cash flows and financial flexibility. A review of Telecom's dividend policy has concluded that in the light of the planned growth in investment, a change in policy is appropriate.

Consequently, Telecom has decided to implement a new dividend policy, which will target a dividend pay-out ratio of around 50% of net earnings. This policy will be dependent on earnings, cash flow, and other investment opportunities that might arise in the future.

As a matter of practice, Telecom will look to pay a dividend at the same rate in each of the first three quarters of the financial year, and set the fourth quarter dividend at a level which accommodates the target ratio for the full year.

### Fourth Quarter Dividends

Ordinary shares	NZ 11.5 cents
American Depositary Shares	*US 43.15 cents
Supplementary dividend (to non-resident shareholders)	
Per ordinary share	NZ 2.03 cents
Per American Depositary Share	*US 7.62 cents

### BOOKS CLOSING DATES

NZ, Australian Stock Exchanges#	1 September 2000
New York Stock Exchange	31 August 2000

### PAYMENT DATES

NZ, Australia	15 September 2000
New York	22 September 2000

\* Based on an exchange rate at 30 June 2000 of NZ\$1.00 to US\$0.4690.

# Australian shares go 'ex' dividend on 28 August 2000.

## EFFECT OF AAPT

AAPT's results have been consolidated with Telecom's results with effect from 1 December 1999. Accordingly, Telecom's consolidated results for the year include AAPT's earnings (adjusted for consolidation items including minority interest and goodwill amortisation) for the seven months to 30 June 2000.

### Reconciliation of Earnings before and after AAPT

	Year Ended 30 June		
	1999 NZ\$M	2000 NZ\$M	Change %
<b>Reported net earnings</b>	<b>834</b>	<b>783</b>	<b>(6.1)</b>
<i>Deduct share of AAPT's earnings#:</i>			
Net earnings before abnormals	-	10	
Abnormals	-	12	
	834	761	
<i>Add back:</i>			
Amortisation of goodwill	-	32	
Funding costs relating to AAPT investment (after tax)	1	53	
<b>Reported net earnings before AAPT</b>	<b>835</b>	<b>846</b>	<b>1.3</b>
Deduct normalisations*	9	-	
<b>Normalised net earnings before AAPT</b>	<b>826</b>	<b>846</b>	<b>2.4</b>

# After minority interest and consolidation items.

\* 1999 earnings have been normalised to exclude net abnormals of NZ\$1 million (see 'Abnormal Items') and release of surplus tax provision (NZ\$8 million).

### Key Indicators

	Year ended 30 June 1999	Year ended 30 June 2000
<b>INCLUDING AAPT</b>		
Operating Margin (%) <sup>1</sup>	41.2	32.6
Asset Utilisation (%) <sup>2</sup>	71.5	70.0
Net Interest Cover (times) <sup>3</sup>	7.2	5.1
Return on Average Total Assets (%) <sup>4</sup>	29.4	22.8
Earnings Per Share (normalised)	47.1	44.0
Net Debt/Net Debt plus Capital Funds (%)	48.3	62.4
<b>EXCLUDING AAPT</b>		
Operating Margin (%) <sup>1</sup>	41.2	39.4
Asset Utilisation (%) <sup>2</sup>	74.4	73.8
Net Interest Cover (times) <sup>3</sup>	7.2	7.4
Return on Average Total Assets (%) <sup>4</sup>	30.6	29.1
Earnings Per Share (normalised)	47.1	48.3
Net Debt/Net Debt plus Capital Funds (%)	42.6	43.1

1 Normalised surplus from operations/operating revenue (before abnormals).

2 Operating revenue (before abnormals)/average total assets (net of cash and short-term investments).

3 Normalised surplus from operations/net interest expense (before interest capitalised) inclusive of capital note coupons.

4 Normalised surplus from operations/average total assets (net of cash and short-term investments).

## FORWARD-LOOKING STATEMENTS

This Management Discussion and Analysis contains forward-looking statements. The words "believe", "expect", "will", "estimate", "project", "forecast", "should", "anticipate", "intend" and similar expressions may identify forward-looking statements. Such forward-looking statements are based on the beliefs of the Company's management as well as on assumptions made by and information currently available to the Company at the time such statements were made. Actual results could differ materially from those projected in the forward-looking statements as a result of the matters discussed herein and certain economic and business factors, some of which may be beyond the control of the Company. Such factors include, but are not limited to, competition in the New Zealand telecommunications market, the outcome of pending litigation, the effect of current or future Government regulation, technological change in the telecommunications industry, and the state of the New Zealand and Australian economies.

## TELECOM (EXCLUDING AAPT)

Telecom's net earnings (excluding AAPT) of NZ\$846 million for the year ended 30 June 2000 increased by NZ\$20 million, or 2.4%, compared with last year's normalised earnings (excluding AAPT) of NZ\$826 million.

On a reported basis, earnings (excluding AAPT) increased by NZ\$11 million, or 1.3%, for the year.

Earnings Overview (excluding AAPT)	Year Ended 30 June		
	1999 NZ\$M	2000 NZ\$M	Change %
Operating revenues*	3,456	3,601	4.2
Operating expenses*	2,033	2,182	7.3
Net earnings (reported)	835	846	1.3
Normalised earnings	826	846	2.4
EBIT* (before abnormals)	1,423	1,419	(0.3)
EBITDA# (before abnormals)	1,981	1,984	0.2

\* Excludes abnormals.

\* Earnings before interest and tax.

# Earnings before interest, tax, depreciation and amortisation.

## OVERVIEW OF RESULTS (EXCLUDING AAPT)

Telecom's results before the effect of the investment in AAPT are summarised in the table on page 35. These results exclude the costs of funding the investment in AAPT, and the effects of consolidating AAPT (i.e. goodwill amortisation and Telecom's share of AAPT's post-acquisition earnings). The consolidated Statement of Financial Performance on page 36 discloses the fully consolidated result.

## Reclassifications

For 2000 Telecom has reclassified wholesale revenue previously included with interconnection revenue into national, international and data revenues. Volumes and prior period revenue have been restated for this reclassification.

# **Management's Discussion and Analysis of Financial Condition and Results of Operations 30 June 2000**

## **Operating Revenues (Before Abnormals)**

Variation - Increase	NZ\$ millions	%
2000:1999	145	4.2

Total revenue (before abnormals) rose by 4.2% for the year to 30 June 2000 compared with 1999, an improvement on revenue growth in the year to 30 June 1999 of 1.0%.

### **Local Service**

Local service revenues consist of business and residential access, local call charges (predominantly paid by business customers), including Centrex and VPN, and enhanced network services products (Smartphone, messaging and call track).

Variation - Decrease	NZ\$ millions	%
2000:1999	(2)	(0.2)

Local service revenues decreased by NZ\$2 million, or 0.2%, compared with 1999.

Local Service	1999	2000	Change %
<b>BUSINESS &amp; RESIDENTIAL ACCESS</b>			
Revenue (NZ\$m)	858	849	(1.0)
Access lines residential (000s)	1,339	1,349	0.7
Access lines business (000s)	348	330	(5.2)
Centrex lines (000s)	76	80	5.3
<b>LOCAL CALLS*</b>			
Revenue (NZ\$m)	133	133	-
Call minutes (m)	3,221	3,348	3.9
<b>SMARTPHONE, MESSAGING AND CALL TRACK</b>			
Revenue (NZ\$m)	68	75	10.3
Call minder mailboxes (000s)	268	271	1.1

\* Includes business local calls, residential calls under NZ20 cents local calling option and Centrex and VPN local calls.

The decrease in access revenue of NZ\$9 million, or 1.0%, was largely due to the first full-year impact of a reduction in line rentals for business customers from January 1999.

Local service revenue and access line growth have been affected by the entry of Saturn Communications (now Telstra Saturn Limited) into the local service market, the migration of local access to ISDN services and increased use of cellular phones.

### **National**

National revenue includes calls to a location outside the caller's local calling area, including Centrex and VPN, calls to cellular networks originating within the fixed line network, National 0800 calls and operator services charges.

Variation - Increase	NZ\$ millions	%
2000:1999	4	0.6

National revenue increased by NZ\$4 million, or 0.6%, for the year, largely due to increases in fixed line to cellular revenues offset by a reduction in national calls revenue as a result of national toll price reductions.

### **National**

	1999	2000	Change %
<b>NATIONAL CALLS</b>			
Revenue (NZ\$m)	356	301	(15.4)
Call minutes (m)	2,089	2,206	5.6
Average price (cents)	170	13.6	(20.0)
<b>CALLS TO CELLULAR NETWORKS</b>			
Revenue (NZ\$m)	218	276	26.6
Interconnect cost (NZ\$m)	44	71	61.4
Gross margin (NZ\$m)	174	205	17.8
Call minutes (m)	429	570	32.9
Average price (cents)	50.8	48.4	(4.7)
<b>NATIONAL 0800</b>			
Revenue (NZ\$m)	110	119	8.2
Call minutes (m)	553	679	22.8
Average price (cents)	19.9	17.5	(12.1)

National calls revenue decreased by 15.4% largely as a result of an approximately 20.0% decline in the average price per call minute, reflecting various capped specials rate reductions.

The BEST (Businesses Enjoy Savings on Tolls) pricing option was launched in February 1999 and was open for enrolment until 30 April 1999. This plan provided a ceiling to business customers on the cost of their tolls until 31 March or 30 April 2000, depending on when they enrolled. The ceiling was 10% lower than the customer's average monthly spend.

In May 1999, new calling plans for residential customers were introduced. These plans offer different combinations of NZ\$3 or NZ\$5 capping and/or maximum off-peak and peak calling rates.

Fixed line to cellular revenue increased by 26.6%. The average price per minute for fixed line to cellular calls declined by 4.7%, but this was more than offset by a significant increase in call volumes resulting from the strong growth in cellular penetration.

The growth in fixed line to cellular revenue was partly offset by an increase in the cost of interconnecting with other cellular carriers (see "Cost of Sales"). The fixed line to cellular margin increased by 17.8% compared with last year.

### **International**

International revenue includes outgoing international calls made in New Zealand, collect, credit card and "New Zealand Direct" calls to New Zealand, receipts from overseas telecommunications administrations and companies for calls to New Zealand that use Telecom's facilities and calls from international switched traffic transiting Telecom's facilities (referred to as "transit calls").

Variation - Increase	NZ\$ millions	%
2000:1999	13	3.4

International revenue increased by NZ\$13 million, or 3.4%, due largely to growth in inward call revenue.

International			Change
	1999	2000	% 00:99
<b>OUTWARD CALLS</b>			
Revenue (NZ\$m)	209	194	(7.2)
Call minutes (m)	473	591	24.9
Average price (cents)	44.2	32.8	(25.8)
<b>INWARD CALLS</b>			
Revenue (NZ\$m)	127	157	23.6
Call minutes (m)	341	429	25.8
Average price (cents)	37.2	36.6	(1.6)
<b>TRANSIT CALL MARGIN</b>			
Margin (NZ\$m)	48	41	(14.6)
Call minutes (m)	377	549	45.6
Average margin (cents)	12.7	7.5	(40.9)

Growth in outward call minutes reflected the volume stimulation from price specials offered to New Zealand customers and significant price reductions over the past year. The annual average per minute charge for outward calls of NZ32.8 cents was 25.8% lower than in 1999, reflecting price reductions and frequent weekend specials.

In February 2000, the price caps on consumer Talk All Day promotions were reduced from NZ\$5 to NZ\$4 for Australia and from NZ\$10 to NZ\$8 for the UK, US, Canada and Ireland.

The increase in inward call revenue for the year resulted largely from increased call minutes. The increase in inward call revenue has largely been offset by an increase in the international outpayment included in cost of sales. This outpayment increased by 14.3% for the year.

The net margin received from Telecom's international business, excluding the transit call margin (outward and inward call revenue less the international outpayment), decreased by 3.8%.

The decrease in the transit call margin (revenue net of outpayments) was largely due to lower average margins per call minute. The increased volumes from the transit business are attributable to the utilisation of a variety of outward routing options and to new transit traffic won by Telecom's points of presence ("POPs") in the US, Japan, Australia and the UK.

International Margin			Change %
NZ\$ millions	1999	2000	00:99
International outwards revenue	209	194	(7.2)
International inwards revenue	127	157	23.6
International outpayment	(154)	(176)	14.3
Net international margin before transits	182	175	(3.8)

#### Interconnect

Interconnect revenue is derived from charges for delivering to and/or accepting from other service providers local, national, international, cellular and 0800 calls. Installation charges and interconnecting links and service delivery point charges are also included.

Variation - Increase	NZ\$ millions	%
2000:1999	15	21.1

Interconnection revenue increased by NZ\$15 million, or 21.1%, largely due to increased activity with existing carriers.

For 2000 Telecom has reclassified wholesale revenue previously included with interconnection revenue into national, international and data revenues. Volumes and prior periods' revenue have been restated for the revenue reclassifications.

While interconnect revenue increased by NZ\$15 million, interconnect costs, including the cost of interconnecting with other cellular carriers, increased by NZ\$48 million, or 85.2% (see "Cost of Sales").

#### Cellular and Other Mobile Services

Cellular and other mobile services revenue comprises access and airtime charges for calls originating from Telecom's cellular network (including international calls), revenue from paging and mobile radio services, cellular equipment (CPE) and other related services.

Variation - Increase	NZ\$ millions	%
2000:1999	44	8.8

Revenue from cellular and other mobile services grew by NZ\$44 million, or 8.8%, compared with 1999. Cellular revenue alone grew by NZ\$42 million, or 8.9%.

Cellular and Other Mobile Services			Change
	1999	2000	% 00:99
<b>CELLULAR AND OTHER MOBILE</b>			
Total mobile revenue (NZ\$m)	502	546	8.8
Mobile cost of sales (NZ\$m)	98	151	54.1
Mobile gross margin (NZ\$m)	404	395	(2.2)
<b>CELLULAR</b>			
Cellular revenue (NZ\$m)	472	514	8.9
Call minutes (m)	799	1,064	33.2
<b>Connections</b>			
Total at period end (000s)	677	980	44.8
Average during period (000s)	561	838	49.4
Average revenue per customer per month (excl. CPE) - NZ\$	70.1	49.5	(29.4)

Telecom had 980,000 cellular connections at 30 June 2000 compared with 677,000 at 30 June 1999, an increase of 44.8%. The continued strong growth in connections is largely due to growth in the prepaid cellular business.

Prepaid service has continued to be popular with consumers, but new pricing plans for postpaid customers, including free minutes and additional services, have also attracted large numbers of customers. The total number of prepaid customers, including third party connections, at 30 June 2000 was 513,000, approximately 52% of total connections.

The total number of cellular connections in New Zealand, including Vodafone New Zealand's ("Vodafone") connections, represents approximately 40% of the New Zealand population. This penetration level, when compared with other countries, suggests scope for continued expansion of this market.

The mobile gross margin (total mobile revenue less cost of sales) decreased by 2.2%, compared with 1999, largely as a result of an increase in cost of sales. Mobile revenue and the mobile margin, set out in the table above, do not include revenue from fixed line to cellular calls terminating on Telecom's cellular network.

Average revenue per cellular customer decreased by approximately 29% compared with 1999, reflecting the higher proportion of prepaid connections. Revenue per prepaid connection is generally lower than revenue per postpaid connection.

Mobile cost of sales increased by 54.1% for the year, reflecting the significant growth in the number of cellular connections over the past year. Special promotions to attract new connections and encourage existing customers to upgrade their mobile phones contributed to the increase in mobile cost of sales.

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## Data

Data revenue consists principally of revenue from data transmission services, dedicated leased lines and Internet access.

Variation - Increase	NZ\$ millions	%
2000:1999	75	21.0

Data revenue increased by NZ\$75 million, or 21.0%, for the year. This growth was driven by demand for bandwidth to support business networking and the increased penetration of the Internet.

Data	1999	2000	Change % 00:99
Internet revenue (NZ\$m)	43	67	55.8
Xtra registered customers (000s)	206	287	39.3
Xtra dial-up hours (m)	17	47	176.5
Average hours per active customer (per month)	11	20	81.8
ISDN revenue (NZ\$m)	56	76	35.7
ISDN channels (000s)	53	72	35.8
New World revenue* (NZ\$m)	68	102	50.0
Old World revenue* (NZ\$m)	191	187	(2.1)

\* Excludes Internet and ISDN revenue.

Internet revenue increased by NZ\$24 million, or 55.8%, for the year. Telecom's Internet service provider "Xtra" had approximately 287,000 registered customers at 30 June 2000, compared with 206,000 at 30 June 1999, an increase of 39.3%. Of the registered customers, approximately 79% were active during the last month of the year.

ISDN revenue increased by 35.7% for the year. The increase in ISDN revenue partly reflected migration from basic access services. The number of ISDN channels at 30 June 2000 increased by 35.8% from 30 June 1999.

New World revenue (which includes ADSL, LanLink and frame relay) increased by 50% for the year reflecting the migration of customers to higher bandwidth and lower cost platforms. New World revenue comprised approximately 35% of data revenue (excluding Internet and ISDN) in 2000 compared with approximately 26% in 1999.

## Directories

Directories revenue is derived largely from local advertising by businesses in both The Telephone Book and YELLOW PAGES® directories and various database services.

Variation - Increase	NZ\$ millions	%
2000:1999	15	9.3

Revenue from regional directories increased by approximately 8% for the year as a result of both tariff and volume growth in both The Telephone Book and YELLOW PAGES® products. Revenues from specialised and LOCAL DIRECTORIES™ increased by approximately 24% largely as a result of volume growth and two new LOCAL DIRECTORIES™.

## Equipment Revenue

Equipment revenue includes non-cellular equipment sales, installation and CPE rental.

Variation - Decrease	NZ\$ millions	%
2000:1999	(25)	(22.9)

Equipment revenue decreased by NZ\$25 million, or 22.9%, compared with 1999, largely as a result of a reduction in equipment sales as Telecom continues to reduce its equipment sales business. The impact on earnings of this decrease in revenue was largely offset by a reduction in equipment cost of sales.

## Miscellaneous Other Services

Miscellaneous other services revenue is derived principally from software development, telecommunications services provided in the Cook Islands and Samoa and international outside plant projects.

Variation - Increase	NZ\$ millions	%
2000:1999	7	12.3

## Operating Expenses (Before Abnormals)

Variation - Increase	NZ\$ millions	%
2000:1999	149	7.3

Operating expenses increased by NZ\$149 million, or 7.3%, for the year. The increase was largely due to higher cost of sales and other operating expenses, partly offset by lower labour costs. If cost of sales were excluded, expenses would have increased by 1.9% for the year. The increase in expenses excluding cost of sales reflects increases in the costs of growth areas such as Xtra, esolutions, the international points of presence and the costs of bidding for contracts in Australia (see "Outsourcing contract with the Commonwealth Bank of Australia").

## Labour

Variation - Decrease	NZ\$ millions	%
2000:1999	(61)	(13.1)

The decrease in labour costs of NZ\$61 million, or 13.1%, for the year largely reflected the outsourcing of information services to EDS effective from 1 September 1999, the sale of ConneCTel effective from 1 June 2000 and the full year impact of the outsourcing of operator services to SITEL during the 1999 financial year. The costs of outsourcing are included in "Other Operating Expenses". These reductions were partly offset by salary increases arising from Telecom's annual salary review process.

Personnel Numbers	June 1999	June 2000	Variation
Operations	5,994	4,463	(1,531)
Other	1,485	1,254	(231)
	7,479	5,717	(1,762)

The decrease in personnel numbers since 30 June 1999 largely reflects the sale of ConneCTel and the outsourcing of information services to EDS.

## Depreciation

Variation - Increase	NZ\$ millions	%
2000:1999	5	0.9

Depreciation expense increased by NZ\$5 million, or 0.9%, in 2000. The year-on-year increase reflects the impact of the increasing fixed asset base resulting from capital expenditure.

## Cost of Sales

Cost of sales are costs directly attributable to revenue earned from international outward calls and leased circuits, equipment sales, cellular services, directories and the costs of interconnection.

Variation - Increase	NZ\$ millions	%
2000:1999	119	25.9

Cost of sales increased by NZ\$119 million, or 25.9%, for the year. This increase was largely due to higher mobile, international, interconnect and directories cost of sales partly offset by lower equipment cost of sales.

Mobile cost of sales increased by NZ\$53 million, or 54.1% (see "Cellular and Other Mobile Services").

While the high rate of cellular connection growth is having a negative impact on short-term earnings performance due to the immediate write-off of cellular acquisition costs, the Company believes significant future revenue will accrue from its recent high number of customer acquisitions.

Most Australasian telecommunications companies have adopted the accounting policy of capitalising cellular acquisition costs and subsequently amortising these costs over the life of the underlying contracts. Telecom has considered adopting this policy but has decided against it at this time. Had Telecom adopted this policy effective from 1 July 1999, mobile cost of sales would have been lower by approximately NZ\$55 million in 2000.

Interconnect expense increased by NZ\$48 million, or 85.2%, reflecting increased volumes including the growth in calls from Telecom's fixed line network to Vodafone's cellular network (see "National").

International cost of sales for outbound calls increased by NZ\$22 million, or 14.3%, for the year reflecting growth in outward call volumes (see "International").

#### Other Operating Expenses

Other operating expenses include occupancy, advertising, computer costs, bad debts, vehicle costs, office expenses, postage and agency, outsourcing costs and certain direct costs, which together represented approximately 80% of other operating expenses before capital recoveries.

Variation - Increase	NZ\$ millions	%
2000:1999	86	15.5

The increase in other operating expenses largely reflected an increase in outsourcing costs. This increase reflected the outsourcing of information services to EDS effective from 1 September 1999, the full year impact of the outsourcing of operator services to SITEL during the 1999 financial year and the sale of ConnectTel.

The increase in other operating expenses also reflects increases in other operating costs of growth areas such as Xtra, esolutions, the international points of presence and the costs of bidding for large corporate contracts in Australia.

#### Abnormal Items

The following abnormal items reduced the 1999 surplus from operations (including abnormals) by NZ\$6 million. After tax, the abnormal items increased 1999 earnings by NZ\$1 million.

	1999 NZ\$M	2000 NZ\$M
<b>ABNORMAL REVENUE</b>		
Liquidation of executive share ownership plan	16	-
Cross border finance lease	15	-
	31	-
<b>ABNORMAL EXPENSES</b>		
Restructuring costs	15	-
Onerous contracts provision	22	-
	37	-

See Note 4 to the consolidated financial statements for further comment on these abnormal items.

#### Net Interest Expense

Variation - Decrease	NZ\$ millions	%
2000:1999		
Interest expense	(13)	(8.7)
Investment income	(9)	(20.0)
Net interest expense*	(4)	(3.8)

\* Excludes the cost of funding the investment in AAPT.

The decrease in net interest expense for the year was partly due to lower short-term interest rates. The surplus from operations before abnormal items covered net interest (after investment income but before interest capitalised) and capital note distribution costs 7.4 times, compared with 7.2 times in 1999.

#### Taxation

Variation - Decrease	NZ\$ millions	%
2000:1999	(7)	(1.7)

The effective tax rate for 2000 was 31.3% compared with 31.9% for 1999 and a statutory rate of 33%.

#### Capital Expenditure

Capital expenditure (excluding AAPT) amounted to NZ\$643 million, an increase of NZ\$29 million, or 4.7%, compared with 1999. Cash applied to capital expenditure (excluding AAPT) amounted to NZ\$633 million, an increase of NZ\$48 million, or 8.2%.

Approximately 60% of 2000 capital expenditure was spent on baseline investment including expenditure for renewal and growth of Telecom's core network (including the international and mobile networks). The remaining capital expenditure was incurred in enhancing network capability to accommodate the increasing demand for data services and in the development of new products and services.

In February 2000, Telecom commissioned communications networking company Lucent Technologies (NZ) Limited to build a mobile phone network based on the code division multiple access ("CDMA") standard. AAPT has also chosen the Lucent Technologies Group as a CDMA supplier. Telecom and AAPT each selected Lucent Technologies as a result of independent evaluations, but Telecom believes that there are operating synergies and benefits with both companies choosing the same vendor.

Excluding AAPT, Telecom currently expects to spend approximately NZ\$1 billion on capital expenditure in the 12 months to 30 June 2001. This includes expected CDMA capital expenditure and purchases of capacity from Southern Cross Cables Limited but excludes any potential acquisition of spectrum that may be purchased from the Government in the current spectrum auctions.

#### LIQUIDITY (CONSOLIDATED)

Telecom believes it has adequate internal and external resources available, including borrowing capacity, to finance its operating requirements, anticipated capital expenditure, dividends and investments.

#### Cash Flows from Operating Activities

Net cash flows from operating activities were NZ\$1,545 million, a decrease of NZ\$72 million, compared with 1999. Higher income tax and interest paid contributed to the decrease, while an increase in receipts from customers was largely offset by an increase in payments to suppliers and employees.

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### Cash Flows from Investing Activities

Net cash flows used in investing activities amounted to NZ\$2,616 million, compared with NZ\$546 million for 1999. The increase largely reflects the acquisition of shares in AAPT and Independent Newspapers Limited ("INL") and an increase in cash applied to the purchase of fixed assets, partly offset by the proceeds from the sale of ConneCTel and AAPT Sat-Tel.

### Cash Flows from Financing Activities

Net cash flows from financing activities were NZ\$1,122 million, compared with cash used of NZ\$1,064 million in 1999. The increase in 2000 was largely due to net proceeds from short-term and long-term debt to fund the AAPT acquisition.

Telecom has declared a fully imputed dividend for the fourth quarter of NZ11.5 cents per share, a total of NZ\$202 million, to be paid in September 2000.

A supplementary dividend of NZ\$25 million will be paid to shareholders who are non-resident in New Zealand. Telecom receives an equivalent tax credit from the Inland Revenue Department for this amount.

## CAPITAL RESOURCES (CONSOLIDATED)

### Cash and Short-term Investments

Telecom had cash and short-term investments of NZ\$698 million at 30 June 2000, compared with NZ\$143 million at 30 June 1999.

Telecom has available unutilised committed facilities of US\$200 million, as well as other substantial uncommitted borrowing capacity. AAPT has available unutilised committed facilities of A\$60 million.

### Debt

Total interest-bearing long-term and short-term liabilities amounted to NZ\$4,323 million at 30 June 2000 compared with NZ\$2,067 million at 30 June 1999.

Net debt amounted to NZ\$3,591 million at 30 June 2000, compared with NZ\$1,898 million at 30 June 1999. The net debt to net debt plus capital funds ratio was 62.4% at 30 June 2000, compared with 48.3% at 30 June 1999. Net debt is deemed to consist of total long and short-term debt, net of cash and short-term investments and a term deposit of NZ\$34 million at 30 June 2000 (NZ\$26 million at 30 June 1999). Capital funds include shareholders' funds, capital notes (TeleNotes and Restricted Capital Securities) and minority interests.

The estimated fair value of Telecom's long-term debt at 30 June 2000 was NZ\$3,146 million compared with its carrying amount of NZ\$3,049 million (stated inclusive of the effect of hedging transactions). The estimated fair value of long-term debt at 30 June 1999 was NZ\$1,314 million, compared with its carrying amount of NZ\$1,250 million (stated inclusive of the effect of hedging transactions). The fair values are based on Telecom's fixed rates of interest on debt in comparison to the prevailing market rates in effect at 30 June 2000 and 30 June 1999 for instruments of a similar maturity.

### TeleNotes and Restricted Capital Securities

In 1997 TCNZ Finance Limited ("TCNZ Finance"), Telecom's main financing subsidiary, issued capital notes known as "TeleNotes". TeleNotes on issue at 30 June 2000 amount to NZ\$438 million.

TeleNotes are unsecured subordinated securities which pay a fixed coupon rate to the holder between election dates. On an election date, holders may elect to retain some or all of their TeleNotes for a further period on terms specified by TCNZ Finance or require redemption. TCNZ Finance has the option to redeem the TeleNotes, including any unpaid interest, for cash and/or by procuring the issue of Telecom shares (valued at 90% of the then-current market share price) to the holders of the TeleNotes.

In February 1998 Telecom New Zealand Finance Limited ("TNZFL"), another Telecom financing subsidiary, issued US\$300 million worth of Restricted Capital Securities ("Capital Securities") to United States-based institutional investors. Such securities are similar to TeleNotes. US\$150 million of such securities have a fixed coupon of 6.25% and will be redeemable in 2003. The other US\$150 million have a fixed coupon rate of 6.5% and will be redeemable in 2008. Telecom has entered into cross currency interest rate swaps to remove the exposure to exchange rate fluctuations that would otherwise result from the issue of the Capital Securities. On the redemption dates in 2003 and 2008, also referred to as election dates, holders may elect to retain some or all of their Capital Securities for a further period on terms specified by TNZFL or require redemption. TNZFL has the option to redeem the Capital Securities including any unpaid interest for cash and/or by procuring the issue of American Depositary Shares representing ordinary shares of Telecom (valued at 90% of the then-current market value) to the holders of the Capital Securities.

### Market Risk

Telecom is exposed to market risk primarily from changes in interest rates and foreign currency exchange rates. Telecom employs risk management strategies including the use of derivatives such as interest rate swaps, interest rate options, foreign currency forwards, foreign currency options and cross currency interest rate swaps to manage these exposures. Any gains or losses on these hedging financial instruments are generally offset by gains or losses on the underlying exposures being hedged. Telecom monitors the use of derivative financial instruments through the use of well defined market and credit risk limits and timely reports to senior management. Telecom does not hold or issue derivative financial instruments for trading purposes.

Telecom is also exposed to market risk arising from changes in equity prices with respect to its investments in shares in listed companies.

### Interest Rate Risk Management

The objectives of interest rate risk management are to minimise the cost of net borrowings and to minimise the impact of interest rate movements on Telecom's interest expense/net earnings within policies approved by the Telecom Board of Directors.

As at 30 June 2000, Telecom had hedged approximately NZ\$10 million of short-term debt through the use of an interest rate swap compared to NZ\$30 million that was hedged in this manner at 30 June 1999. As at 30 June 2000, interest rate options totalling NZ\$450 million had been transacted to hedge forecast short-term debt. As at 30 June 1999, interest rate options totalling NZ\$300 million had been transacted to hedge forecast short-term debt. Interest rate swaps have also been used to convert Telecom's floating rate obligations on term funding into fixed rate obligations.

The following table provides a sensitivity analysis of the estimated fair values of long-term debt, capital notes and related derivatives, assuming an instantaneous 100 basis point upward and downward parallel shift in the yield curve as at 30 June 2000 and 1999.

	Fair value	Fair value assuming 100 basis point upward shift	Fair value assuming 100 basis point downward shift
<i>NZ\$ billions</i>			
<b>AS AT 30 JUNE 2000</b>			
Long-term debt, capital notes and related derivatives	4.1	3.9	4.4
<b>AS AT 30 JUNE 1999</b>			
Long-term debt, capital notes and related derivatives	2.3	2.2	2.4

### Foreign Exchange Risk Management

The objective in managing foreign exchange risk is to protect against the risk that the eventual New Zealand dollar net cash flows resulting from purchases from foreign suppliers and foreign currency borrowings and expenditure will be adversely affected by changes in foreign currency exchange rates.

As at 30 June 2000, Telecom had used cross currency interest rate swaps with a contract value of NZ\$2,063 million to hedge long-term debt denominated in US dollars, Euros, Swiss francs and Japanese yen. Such swaps were also used to hedge the issue of NZ\$512 million equivalent of US dollar denominated Restricted Capital Securities. As at 30 June 1999, Telecom had used cross currency interest rate swaps with a contract value of NZ\$925 million to hedge long-term foreign currency denominated debt and Restricted Capital Securities.

As at 30 June 2000, Telecom had also used foreign exchange forwards and foreign currency options with contract values of NZ\$1,138 million to hedge short-term debt (principally denominated in US dollars), firm purchase commitments (mainly denominated in US dollars and Japanese yen), and partially hedge the investment in AAPT Limited. As at 30 June 1999, the contract value of such instruments was NZ\$1,500 million.

The following table provides a sensitivity analysis of the estimated fair values of foreign exchange contracts hedging firm purchase commitments and the investment in AAPT in 1999, assuming a 10% increase or decrease in the various exchange rates to which Telecom is exposed.

NZ\$ millions	Fair value	Fair value assuming 10% increase	Fair value assuming 10% decrease
<b>AS AT 30 JUNE 2000</b>			
Foreign currency forward exchange contracts, and options	60	4	127
<b>AS AT 30 JUNE 1999</b>			
Investment in AAPT	337	324	352
Foreign currency forward exchange contracts	25	(4)	59

The functional currency for nearly all of Telecom's foreign operations is the local currency. The translation of statement of financial performance and statement of financial position balances of these entities into New Zealand dollars results in translation adjustments, which are recorded in the foreign currency translation reserve. As at 30 June 2000, Telecom's primary translation exposure was to the Australian dollar in respect of the Australian subsidiary that holds the investment in AAPT. This exposure is partially hedged, with gains or losses on the hedging contract also recorded in the foreign currency translation reserve.

### Equity Risk

During the year ended 30 June 2000, Telecom acquired minority investments in publicly listed companies. These investments expose Telecom to the risk of movements in the market prices of these listed securities. Telecom does not hedge this risk. The following table provides a sensitivity analysis of the estimated fair value of listed securities, assuming a 10% increase and decrease in the market prices of securities in which Telecom holds investments.

NZ\$ millions	Fair value	Fair value assuming 10% increase in share price	Fair value assuming 10% decrease in share price
<b>AS AT 30 JUNE 2000</b>			
Listed securities	158	173	142

### ECONOMIC TRENDS

Telecom's operations are significantly affected by the state of the New Zealand economy. Gross Domestic Product ("GDP") grew in real terms by 4.4% for the year ended March 2000, after a contraction of 0.2% in the year ended March 1999.

Growth is forecast to continue over the next two years although with moderation in the rate of growth. The New Zealand Institute of Economic Research reports (June 2000) a consensus among forecasters of 4.0% for GDP growth in the year to March 2001; the consensus for the March 2002 year is 3.0%. These forecasts reflect expected growth in export sales by primary producers and manufacturers, and higher levels of domestic spending by the Government. Services are an expanding component of the economy, with communications consistently among the sectors of fastest growth.

New Zealand's balance of payments deficit deteriorated in the year ended March 2000 (NZ\$8.3 billion) but the consensus forecast is for steady improvement by March 2002, due to rising export sales and reduced demand for imports. Inflation is widely expected to remain low, with annual rates held between 2.0-3.0%. The official rate of unemployment is forecast to continue declining from 6.4% in March 2000, to 5.5% in March 2002. The New Zealand population was around 3.8 million in June 2000.

### COMPETITIVE ENVIRONMENT

New Zealand has highly competitive markets in telecommunications services, governed by the Telecommunications Act 1987 and the Commerce Act 1986. There have been no statutory entry barriers to telecommunications markets since 1989 and services are provided by substantial network operators in addition to Telecom. These include Vodafone, Telstra Saturn Limited ("Telstra Saturn") and Clear Communications Limited ("Clear"), a wholly owned subsidiary of British Telecom. Telecom continues to be subject to Kiwi Share Obligations ("KSO") under which it must maintain a free local calling option for residential customers in all areas of New Zealand where such services were provided in 1990.

In February 2000, the Government established a Ministerial Inquiry into Telecommunications, with an objective to "ensure that the regulatory environment delivers cost-efficient, timely and innovative telecommunications services on an ongoing, fair and equitable basis to all existing and potential users". This inquiry is due to make policy recommendations in September 2000. A draft report in June 2000 proposed "industry self-management with regulatory underpinning", to be provided by a new industry forum and an Electronic Communications Commissioner. Telecom has made extensive submissions to the inquiry, stating the importance of industry agreement on principles for network interconnection and of continuation of the KSO with modifications that recognise industry developments since 1990. Telecom expects amendments will be made to legislation governing telecommunications as a result of final recommendations from the inquiry.

Under the Telecommunications (Information Disclosure) Regulations 1999, Telecom will be required to disclose the value of residential service subsidies under the KSO and report on the financial results of its local access network business separate from all other operations. These disclosures will initially be for the six months ended 30 June 2000.

Telecom has extensive interconnection arrangements with other network operators and service providers. These agreements cover international services, national and local voice services, data services, cellular services, Internet services and mobile trunked services. Telecom now has interconnection agreements with 11 other carriers. Of these, eight have the ability to offer local services and in each case Telecom has a number portability agreement in place enabling competitors to provide customers with the option of changing between local service providers without the need to change numbers.

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During the year under review, Telecom and Vodafone renewed and amended the interconnection arrangements between their networks. In July 2000, Telecom and Telstra Saturn reached a comprehensive new agreement on interconnection, wholesale services, Internet traffic, pole-sharing and settlement of litigation on rebilling. This agreement introduced the principle of "bill and keep", involving no payment for the termination of prescribed local calls where volumes of those calls between networks are reasonably in balance. The renegotiation of interconnection terms with Clear was commenced in May 2000. The current interconnection agreement with Clear expires in December 2000.

In addition to those companies with which Telecom has interconnection, numerous other organisations offer voice-calling services from overseas or by re-selling services from network operators in New Zealand. As at 30 June 2000 approximately 150 Internet Service Providers ("ISPs") operate in New Zealand and 103 of these have asked for access to the Telecom network through 0867 dial-up numbers. Telecom competes in the ISP market through its Xtra operation.

Telecom also faces competition in leased-line services, paging, directory publishing and supply, and installation and maintenance of customer premises equipment ("CPE"). Telecom expects strong competition to continue in New Zealand telecommunications markets.

### LITIGATION

Telecom is currently involved in a number of legal proceedings, including lawsuits brought against and by Clear relating to a variety of issues, including the terms on which Telecom provides interconnection, Clear's failure to make payment of certain charges under its interconnection agreement, Telecom's bundling practices and Telecom's 0867 service. CallPlus Limited and two other companies have proceedings against Telecom in relation to Telecom's 0867 service. The Commerce Commission has issued proceedings against Telecom claiming that the introduction of 0867 constituted a use by Telecom of its dominant position for proscribed purposes. AAPT is currently involved in lawsuits brought by and against Telstra Corporation. See Note 21 to the consolidated financial statements for further comment on these proceedings.

The legal proceedings pending against Telecom and AAPT involve claims for substantial damages and other relief. There can be no assurance that such litigation will not have a material adverse effect on Telecom's and AAPT's business, financial condition or results of operations.

### OTHER MATTERS

#### Southern Cross

Southern Cross was established in October 1998 to build, own, operate and maintain a trans-Pacific fibre optic cable network (called the Southern Cross Cable Network) as well as market capacity on the cable. Telecom, Cable & Wireless Optus and MCI WorldCom are the shareholders in Southern Cross. Telecom holds a 50% equity interest.

Testing is currently underway as Southern Cross prepares to bring its 31,000 km trans-Pacific cable into service in November 2000. Southern Cross expects to deliver a network incorporating a full fibre ring linking Australia, New Zealand, Fiji and Hawaii, and a direct link from Hawaii to Oregon and to California (which are terrestrially linked).

Southern Cross cable construction costs are being funded through a US\$640 million external credit facility and interim funding provided by the shareholders. Telecom has committed to provide up to US\$150 million as part of this interim funding and as at 30 June 2000 Telecom had advanced US\$120 million (excluding accrued interest) as part of this interim funding arrangement. Southern Cross plans to refinance the external credit facility, and repay all outstanding interim funding from shareholders on or before 15 November 2000.

Southern Cross will hold its third Data Gathering Meeting ("DGM") in Hawaii in August 2000. The company's two previous DGMs generated total capacity sales of around US\$1.1 billion.

Based on current capacity commitments and expected revenue forecasts, it is expected that Southern Cross will repay borrowings in the first few years after completion of construction.

Prior to 31 December 1999, the accumulated equity accounted losses of the Southern Cross group included a provision against Telecom's advance to Southern Cross Cables Holdings Limited, a Southern Cross group company. Now that capacity sales commitments have largely covered the cable construction costs, there is no longer a requirement to maintain the provision against this advance.

#### Sale of ConnectTel

During April 2000, Telecom announced the sale of ConnectTel, its network, design, build and maintenance subsidiary, to Downer Group Limited. Many telecommunications companies already use outside contractors and it is no longer necessary for Telecom to own a contractor in order to maintain the high quality of its service. Telecom will continue to work closely with ConnectTel, which has won a significant number of Telecom's design, build and maintenance contracts in a competitive tendering process.

The transaction settled on 1 June 2000. The sale had a minor favourable impact on Telecom's earnings.

#### Investment in EDS New Zealand Limited

Telecom has acquired a 10% shareholding in EDS New Zealand Limited ("EDS"), announced when Telecom outsourced its IT requirements to EDS in September 1999.

The agreement also includes options for Telecom to acquire further shares in EDS between 1 September 2000 and 31 March 2004. If these options are exercised Telecom could take a shareholding of up to 49%. Telecom has appointed two representatives to the board of EDS.

#### Outsourcing Contract with the Commonwealth Bank of Australia

Telecom, in conjunction with AAPT and EDS Australia, has entered final negotiations with the Commonwealth Bank of Australia ("CBA") to provide outsourced telecommunications to support CBA's online leadership position in a five year, A\$500 million deal. Under the outsourcing arrangement Telecom will lead a consortium that provides CBA's telecommunications services including: IP-anywhere network capability; managed network services for data, voice, video, and EFTPOS; remote access and international network services; consulting on all telecommunications requirements; and risk, security and performance management.

#### Investment in INL

During the year Telecom purchased a 10% stake in INL. Through this small strategic position, Telecom hopes to build a closer relationship over time, in order to provide a further opportunity for accessing potential synergies in the future. This relationship should enhance Telecom's transition from a traditional telecommunications company to an online and solutions provider.

#### Corporate Venture Capital Fund

During the year Telecom established TMT Ventures, a corporate venture capital fund with a target of NZ\$150 million to be invested in new growth businesses in the technology, media, and telecommunications sectors of New Zealand and Australia.

Telecom proposes to make a cornerstone investment of up to NZ\$40 million in TMT Ventures and has appointed a joint venture between United States-based Advent International and Direct Capital (New Zealand's largest venture capitalist), to manage the fund.

### esolutions

During 2000, Telecom entered into an alliance with EDS and Microsoft in New Zealand, to develop and market packaged and customised electronic commerce products and services for New Zealand businesses using the brand "esolutions". The esolutions alliance facilitates provision of services by its members as "applications service providers" and "applications infrastructure providers".

Services provided under the auspices of the esolutions alliance are designed to meet the needs of businesses of all sizes and complexities (except small offices/home offices) and at any stage of their development. esolutions alliance members specialise in providing packages that meet the complex requirements of businesses and enable them to function online. These packages include hosted applications based on the "virtual office". esolutions alliance members draw on the complementary assets, expertise and business associations of Telecom, EDS and Microsoft.

### AAPT

#### AAPT Earnings for the seven months to 30 June 2000

	7 months to June 2000 A\$M
Operating revenues	593
Operating costs	570
EBIT	23
EBITDA	51
Abnormal items (before tax)	23
Net earnings including abnormals	32

AAPT's reported net earnings for the seven months to 30 June 2000 were A\$32 million. AAPT contributed NZ\$10 million of net earnings before abnormals to Telecom's consolidated net earnings for 2000. This contribution was after allowing for minority interests in AAPT's net earnings before abnormals and consolidation adjustments for differences in accounting policies.

Allowing for minority interests and the amounts required to be applied to Telecom's fair value of AAPT's assets at the time of acquisition, AAPT's abnormal items of A\$23 million (see "Abnormals") resulted in a NZ\$12 million contribution to Telecom's consolidated net earnings for the year.

### Abnormals

Over the seven month period AAPT reported abnormal income before tax of A\$23 million resulting predominantly from the sale of AAPT's wholly owned subsidiary, AAPT Sat-Tel, partly offset by the impact of changes in accounting policies.

During the seven month period, AAPT changed its accounting policies in areas relating to subscriber acquisition costs and the recognition of future benefits arising from international return traffic, following a review of its accounting policies.

### AAPT Capital Expenditure

Capital expenditure for the seven month period of A\$180 million included major expenditures for the LMDS and CDMA networks as well as further expansion of AAPT's backbone which includes acquisition of capacity from Optus and deployment of optical fibre through the central business districts of Australia's major capital cities. During the year AAPT has invested in international cable arrangements including the Sea-Me-We3 cable system linking Australia to Europe through Asia and preparatory work in anticipation of the completion of the Southern Cross link to the USA.

### Projected Capital Expenditure

Based on current forecasts, AAPT expects to invest in excess of A\$500 million in the full year to 30 June 2001 as it continues to pursue further development of its first mile access capabilities via roll-out of its LMDS, CBD Fibre, xDSL and CDMA networks.

### Bond Issue and Credit Rating

In March 2000, AAPT Limited was assigned an 'A+' long-term and 'A-1' short-term corporate credit rating by Standard and Poors, with a stable outlook. This followed a request by AAPT for a credit rating in order to assess its debt-funding opportunities. Having received this credit rating, AAPT was able to source investment grade debt at a lower cost. The rating also expands the options available to AAPT to meet current and future capital expenditure requirements.

Following this positive credit rating and as part of its funding programme AAPT announced in early July 2000 that it had established an A\$600 million debt funding securities programme comprising Commercial Paper and Medium Term Notes.

### AAPT OTHER MATTERS

#### Business, Corporate and Government Tenders

During the period AAPT's Business, Corporate and Government ("BCG") division won a number of significant tenders.

It has a major involvement in the recently awarded Commonwealth Bank telecommunications contract, led by Telecom. AAPT's role in this contract will be as the carrier of voice, data and video services. In addition to the benefits of increased revenue and the ability to further leverage its network infrastructure, AAPT believes the Commonwealth Bank contract will strengthen its credibility in the corporate market and this in turn will enable AAPT to capture further opportunities in this market in coming periods.

Other major contracts include the A\$18 million contract to provide outgoing voice services to Centrelink and the Department of Family and Community Services.

The BCG division is also leveraging and driving benefits from the relationship with Telecom. Both companies are working together and have achieved success in securing Trans Tasman telecommunications business on both sides of the Tasman.

### VicOne

AAPT owns and operates the largest secure private IP network in Australia for the Victorian Government called VicOne.

During the year VicOne was expanded to link over 3,500 sites, including schools, hospitals, police stations, courts and all other public sector facilities and currently services over 700,000 daily users.

As part of this expansion, the South West Alliance of Rural Hospitals connected its state-of-the-art Internet-based communications systems to VicOne, enabling the participating hospitals to move all their data, voice and video over the network and saving them an estimated A\$400,000 annually.

### Residential Market

As at 30 June 2000 AAPT Smartchat, AAPT's residential telephony division, had signed up over 300,000 or 5% of the overall residential local call market since launching its bundled residential telephony product in late 1999 following the Australian Competition and Consumer Commission (ACCC) ruling in July 1999 that Telstra must offer wholesale local call services to its competitors.

As a result of this launch and AAPT's marketing push into regional Australia, AAPT has established an additional call centre with 300 seats in Bendigo, Victoria. This call centre currently has 100 seats and will be fully operational by June 2001. An interim 90-seat facility has been established in Melbourne to accommodate the demand arising from the bundled residential telephony product promotion.

### **Regional Australia**

In October 1999, AAPT Regional & Rural was formed to address the telecommunications needs of regional Australia and provide solutions to this market. As part of this initiative, AAPT recently won a tender as the primary telecommunications carrier to one of Australia's first regional community owned telecommunications companies, the Bendigo Community Telco Group.

### **Further Developing First Mile Access Capabilities**

AAPT remains focused on further developing its first mile access capabilities as this will enable AAPT to deliver more services to its customers over its own network.

AAPT is committed to expanding its first mile access capabilities, through rolling out its LMDS, CBD Fibre, xDSL and CDMA networks. By doing so AAPT anticipates achieving better margins rather than relying on other carriers and also delivering its customers the benefits of faster, higher quality, more innovative, competitively priced products and services.

### **Local Multipoint Distribution Service ("LMDS")**

AAPT is currently rolling out a broadband wireless network around Australia based on LMDS technology.

LMDS is currently being used commercially by customers in Melbourne, including the provision of high-speed Internet access to a number of schools on the VicOne network and the provision of voice, data and high speed Internet to a number of corporate CBD-based customers.

This network complements AAPT's existing investment in voice and data switching capabilities and CBD fibre loops. It enables the company to deliver up to and beyond 100 Mbps per customer site and provide voice services, high-speed data and IP-based services and emerging multi-media applications (for example, video on demand and information content).

During the current year the focus of the LMDS roll-out was on testing, site acquisition, site build and integration with the AAPT core network.

AAPT's deployment of point to multi-point LMDS has been impacted by delays in the delivery of equipment. AAPT is working closely with the joint owners of SpectraPoint, Motorola and Cisco Systems, to address the issues.

In the interim, AAPT is continuing to deploy point to point LMDS equipment using the spectrum purchased in 1998.

### **CBD and Metropolitan Fibre**

AAPT is building a fibre optic network in the six capital city CBD areas which directly connects high-volume customers to AAPT's network via a high-speed link.

AAPT has 668 kilometres of fibre optic cable in the CBD and metropolitan areas of Sydney, Melbourne, Brisbane, Adelaide, Perth and Canberra, and as at 30 June had fibred 217 buildings. This will provide savings from the elimination of high cost Telstra leased circuits connecting Telstra's gateway exchanges to AAPT's switches.

### **Acquisition of National High Bandwidth Network**

In March 2000, AAPT and Cable & Wireless Optus ("Optus") signed an agreement under which AAPT will acquire a high bandwidth network on Optus' national backbone linking Cairns, Brisbane, Sydney, Canberra, Melbourne, Adelaide and Perth. Also as part of this agreement, Optus will provide 50 regional drop off points and AAPT will install equipment to link the drop off points with its regional points of presence.

This acquisition will provide AAPT with significant additional capacity to carry more traffic on its own network, further reducing interconnect costs with other carriers and therefore reducing AAPT's transmission costs.

AAPT is currently working with Optus to implement this agreement and expects to have full use of this network by the first quarter of 2001. In the interim, and as part of this agreement, AAPT has use of Optus' backbone network.

### **Cellular One and AAPT Mobile**

Cellular One and AAPT Mobile are both resellers of Vodafone and Optus GSM products and during the year, despite competition in the mobile market, reported an increase of 29.5% to approximately 215,000 customers.

AAPT expects competition in the GSM mobile market to further intensify in the coming periods due to the advent of new technology, the reworking of existing products and the influx of new competitors. To combat this competition and strengthen its distribution channels with the forthcoming launch of AAPT's CDMA mobile network, Cellular One will open a number of new retail outlets over the coming periods, increasing the number to approximately 250.

### **Code Division Multiple Access (CDMA) Mobile Network**

AAPT owns 800MHz spectrum with an addressable market of over 55% of the Australian population and is rolling out a mobile network based on CDMA technology.

Roll-out of this network began earlier in 2000, following AAPT's decision to contract US communications networking company, Lucent Technologies, to build and support its A\$500 million CDMA mobile network. As part of this contract, AAPT has an option to migrate its CDMA network to 3G. Telecom has also contracted Lucent as the supplier for its CDMA mobile network.

Initial roll-out has been slower than planned, due to factors related to base station site acquisition, and as such AAPT expects to launch its network commercially in the first quarter of 2001. Prior to this, a soft commercial launch is planned for South East Queensland in November 2000.

### **Internet and e-commerce Business**

During the period AAPT continued to enhance its Internet and e-commerce business through acquisitions, strategic alliances and partnerships.

To enhance its residential Internet offerings, AAPT entered a 50/50 venture with America Online.

In the business Internet space, connect.com.au, which is one of Australia's largest Internet access and e-commerce providers and a wholly owned subsidiary of AAPT, together with AAPT acquired Australian e-commerce solutions provider, Commerce Solutions; entered an e-procurement licensing agreement with US software provider, Ariba; and acquired 60% of EC-Pay Pty Ltd, which owns and markets a specialist Internet-based service for the superannuation industry.

### **Key Regulatory Decisions**

The two regulatory areas that will impact AAPT this year are the progress of arbitration and further introduction of Number Portability (see below).

#### **Arbitration**

AAPT is currently engaged in eight arbitrations under the Access regime. Recent decisions by the ACCC in relation to Telstra PSTN Access undertakings had favourable outcomes for AAPT. AAPT is awaiting indication of the progress on three arbitrations, seeking to reduce the price of fixed to mobile calls.

#### **Number Portability**

Local Number Portability ("LNP") has been available to all carriers since November 1999. Customers can now keep their local numbers when taking AAPT's bundled residential telephony service.

Freephone Number Portability will be available from 16 November 2000 and Mobile Number Portability ("MNP") from 25 September 2001. Both are favourable for AAPT as they will increase the attraction of AAPT's services to customers.

## RECENT US ACCOUNTING PRONOUNCEMENTS

The future impact of recent US accounting pronouncements issued by the Financial Accounting Standards Board ("FASB") and Securities and Exchange Commission ("SEC") applicable to Telecom's financial statements is discussed below.

### FASB Accounting Standard – Derivatives and Hedging Activities

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 133, "Accounting for Derivative Instruments and Hedging Activities".

This statement requires entities that use derivative instruments to measure these instruments at fair value and recognise them as either assets or liabilities on the balance sheet. It also requires entities to reflect the gains or losses associated with changes in the fair values of these derivatives, either in earnings or as a separate component of capital funds, depending on the nature of the underlying contract or transaction.

In June 1999, the FASB issued SFAS 137, "Accounting for Derivative Financial Instruments and Hedging Activities – Deferral of the Effective Date of SFAS 133". This statement addresses certain implementation issues as well as deferring the effective date of SFAS 133 to financial years beginning on or after 15 June 2000.

In June 2000, the FASB issued SFAS 138, "Accounting for Certain Derivative Instruments and Hedging Activities – an amendment of SFAS 133". This standard further amends the accounting and reporting standards of SFAS 133 for certain derivative instruments and certain hedging activities. SFAS 138 makes no further amendment to the effective date of SFAS 133.

Telecom adopted the provisions of SFAS 133 for US GAAP reporting purposes at 1 July 2000. The types and purposes of derivative financial instruments entered into by Telecom are described in Note 19 to the consolidated financial statements. Due to the qualifying nature of Telecom's derivative financial instruments for hedge accounting under SFAS 133, the application of SFAS 133 is not considered to have a material impact on Telecom's financial statements.

### SEC Staff Accounting Bulletin – Revenue Recognition

In December 1999, the SEC issued Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements". SAB No. 101 provides additional guidance on revenue recognition, as well as criteria for when revenue is generally realised and earned, and also requires the deferral of incremental direct selling costs.

In March 2000, the SEC issued SAB No. 101A "Amendment: Revenue Recognition in Financial Statements", followed in June 2000 by SAB 101B "Second Amendment: Revenue Recognition in Financial Statements". The effect of these amendments is to defer the effective date of SAB 101. Telecom will now have to adopt SAB 101 in its US GAAP reconciliation for the year ending 30 June 2001.

Telecom management is currently evaluating the impact of the adoption of SAB 101 on the financial statements.

## GLOSSARY

**ADSL (Asymmetric Digital Subscribers Line)** – A technology for delivering a high bit rate link to customers over ordinary copper. Data rates can reach 8 Mbit/s from the exchange to the customer and 640 bit/s in the other direction.

**Bandwidth** – Transmission capacity. The larger the bandwidth, the greater the capacity of voice, video or data that can be carried.

**CDMA (Code Division Multiple Access)** – An advanced radio spectrum sharing technique used in new digital mobile networks.

**Centrex** – The use of conventional PSTN lines and phones so that they appear to be part of a private network. Features include traditional PBX features. Centrex is offered to businesses as an alternative to buying or leasing their own PBXs.

**CPE (Customer Premises Equipment)** – Any telecommunications equipment that resides in the customer's premises and does not constitute part of the network (e.g. telephones, fax machines, PBXs).

**IP (Internet Protocol)** – A principal communications protocol used in the Internet.

**ISDN (Integrated Services Digital Network)** – Switched digital transmission system that can carry a range of digitised voice, data and images. Basic Rate Access offers 128 Kbit/s capacity on two channels and Primary Rate Access offers 2 Mbit/s capacity on 30 channels.

**LAN (Local Area Network)** – A local area network is one which spans a limited geographical area (usually within one building or site) and interconnects a variety of computers and terminals, usually at very high data rates.

**LanLink** – A group of Telecom services that link customer LANs together via a Wide Area Network (WAN). Solutions involve a degree of customisation in each case.

**LMDS (Local Multipoint Distribution System)** – A wireless system for distribution of broadband services that functions in the 26 to 29 GHz band.

**PBX (Private Branch Exchange)** – Customer premises switch, connected to the PSTN, that operates as a private local exchange, typically providing reduced-digit dialing for internal calls.

**PSTN (Public Switched Telephone Network)** – A nationwide switched fixed line voice telephone network.

**VPN (Virtual Private Network)** – A carrier-provided service in which the public switched network provides the equivalent of a privately established customer network.

**xDSL** – A generic reference to any of the many Digital Subscribers Line technologies, e.g. ADSL.

**3G (Third Generation – mobile network)** – Digital mobile network based on CDMA standards that is capable of delivering data rates up to 2Mbit/s.